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SENSITIVE
SIPDIS
STATE FOR WHA/CAR (JMACK-WILSON)(RALVARADO)(VDEPIRRO)(WSMITH)
WHA/EPSC (MROONEY) (FCORNEILLE)
EEB/IFD/OMA
WHA/PPC (JGONZALEZ)
INR/RES (RWARNER)
INR/I (SMCCORMICK)
SANTO DOMINGO FOR FCS AND FAS
TREASURY FOR ERIN NEPHEW
EXPORT IMPORT BANK FOR ANNETTE MARESH

E.O. 12958: N/A
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JM, XL
SUBJECT: JAMAICA: JAMAICA'S FISCAL MALAISE

REF: KINGSTON 361; KINGSTON 788

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Summary

¶1. (SBU) Only five months after outlining its spending plans, the Government of Jamaica (GOJ) has announced a USD 67 million increase in expenditures for the current fiscal year. The hike comes after repeated pronouncements from Prime Minister (PM) Bruce Golding about deep cuts in the expenditure budget to compensate for the dramatic fall off in revenues. The first Supplementary Budget tabled in Parliament on August 24 will therefore increase the original budget to USD 6.3 billion. This hike was due to higher than anticipated interest costs, as other areas of proposed spending were slashed. With the GOJ only able to implement a limited tax package, the fiscal deficit will jump to 8.7 percent of GDP from 5.5 percent. This deficit will be financed by further borrowing from the capital market, adding to the GOJ's gargantuan stock of public debt. But even with the proposed rationalization of the public sector, Jamaica's perennial fiscal malaise might not improve until the debt overhang is addressed. End summary.

Budget Shocker

¶2. (SBU) The GOJ has been forced to revise its fiscal targets to present a more credible budget to the IMF in order to access a USD 1.2 billion loan. In its pursuit of this goal, the cash-strapped GOJ has had to perform a major juggling act, chopping USD 143 million from program spending and USD 67 million from capital spending to offset part of the additional USD 280 million in interest costs. The net effect is that the original budget will be increased by USD 67 million to USD 6.3 billion. However, this result runs counter to the position articulated by Golding in the months leading up to the tabling of the estimates. The PM had given the impression that 20 percent of the USD 10 billion budgeted for programs and 15 percent of the capital budget would be slashed to reduce the original budget.

¶3. (SBU) The original budget presented in April 2009 targeted a fiscal deficit of 5.5 percent of GDP (Reftel A). However, by the

end of August 2009 these targets were derailed due to the falloff in revenues. Revenues for the five month period were 10 percent or USD 130 million less than expected, while expenditures were almost in line with projections. For the entire 2009/10 fiscal year, the government is now expecting: (1) revenues to decline by USD 150 million or the equivalent of 1.1 percent of GDP; (2) the divestment program to be postponed to the next fiscal year (1.2 percent of GDP) (Reftel B); and, (3) interest cost to increase by a further 1.5 percent of GDP. These changes are expected to result in an increase of the fiscal deficit to 8.7 percent of GDP or about USD 1 billion. To finance the budget, the GOJ has imposed a further tax package of USD 19 million, with the remaining amount to be sourced from the capital market. This increased borrowing is expected to keep real interest rates high, providing further conflict between the Ministry of Finance and the Bank of Jamaica.

Interest Rate Dissonance Hurts Fiscal Performance

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¶4. (SBU) In a bid to arrest the runaway depreciation of the Jamaican dollar, the central bank raised interest rates to as high as 24 percent at the end of 2008. This had a deleterious effect on the fiscal accounts as, strapped for cash, the GOJ was forced to borrow at onerous rates of interest. Since August 2009, the central bank has begun to reduce rates once again, but not before the GOJ's entire debt portfolio had been realigned toward higher yielding instruments with longer maturity. At the current rate of 17 percent, real interest rates are about seven percent, while inflation has moderated to 10 percent. The central bank has

expressed a desire to reduce rates more aggressively, but appears to be hindered by the need to maintain monetary stability and, by extension, exchange rate and price stability. And despite the reduction in inflation, domestic investors remain unwilling to accept lower rates, suggesting declining levels of confidence in the government's ability to pay.

Heroes Circle and Nethersole Place Clash

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¶5. (SBU) The apparent dissonance between the Heroes Circle-based Ministry of Finance and the Bank of Jamaica situated at Nethersole Place is nothing new. Ministry of Finance officials have long told Emboffs that the central bank operates like an independent institution, concerned only with maintaining exchange rate and price stability. Minister of Finance Audley Shaw has also used a number of his public speaking engagements to address the need for low interest rates, which he calls the lifeblood of the economy. At least two ministry sources have told Emboffs that the Minister is dissatisfied with central bank governor Derrick Latibeaudiere, but is unable to find a suitable replacement. The problem appears to be unresolved, as only weeks before the BOJ started reducing signal rates the MOF issued a number of long term high interest rate instruments. Golding subsequently told a group of business leaders that this long standing problem should be resolved following the appointment of Dr. Wesley Hughes as Financial Secretary. Hughes, a former Deputy to Latibeaudiere and Director General of the Planning Institute of Jamaica, is expected to bridge the divide between Heroes Circle and Nethersole Place.

Opposition Critical of Revised Budget

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¶6. (SBU) The revised budget has come under attack from the opposition Peoples National Party (PNP), with its Spokesman on Finance, Omar Davies, describing the new estimates as still lacking in credibility. He bemoaned the fact that the original budget was predicated on the premise that everything that could go right would, but the deteriorating economic conditions had blown the estimates off track. Davies, who has been proposing a special temporary cessation on high yielding debt, is of the opinion that

the revenue projections remain ambitious and warned Shaw to take a second look at the figures before presenting them to the International Monetary Fund (IMF). He also reiterated the need to take a surgical look at expenditures, arguing that cutting the public sector was not the solution to the fiscal crisis.

¶7. (SBU) However, Hughes has defended the new estimates, suggesting that they are credible, technically sound, and able to stand up to the scrutiny of the IMF. Hughes noted that the cuts, while painful, were necessary if Jamaica was to present a credible budget to garner support from the Fund. According to Hughes, the bottom line is that revenues are lagging projections and expenditures have been higher than anticipated, and that to deal with the imbalance there has to be a cut in spending, increased taxes, or a combination of both. "It is as simple as that", Hughes opined. He further stated that the revised budget provides a basis for a sustainable medium term economic program.

Comment

¶8. (SBU) The early presentation of the supplementary budget is an indication that the original forecasts were overly ambitious, suggesting the GOJ continues to underestimate the impact of global economic crisis on Jamaica. The early revision would have also formed part of the IMF's condition for providing balance of payments support to Jamaica. However, the most important revelation from the revised estimate is that the country is sinking deeper into a fiscal quagmire due largely to its unsustainable levels of borrowing and, by extension, stock of debt. It would

therefore appear that until the debt overhang is addressed, the GOJ will only be treating the symptoms of fiscal problems. However, unless the IMF forces a decision, the problem might extend into the next fiscal year, as the Jamaican government remains reticent to take a serious look at a voluntary debt operation, fearing the repercussions in the international capital market. The GOJ has instead signaled its intention to restructure the less burdensome public sector which, while necessary, will not be sufficient to stem the fiscal malaise. End comment.
Parnell